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Proposed statement on standards for accounting and review services : Compilation of specified elements, accounts, or items of a financial statement; Compilation of specified elements, accounts, or items of a financial statement; Exposure draft (American Institute of Certified Public Accountants), 2005, March 18

American Institute of Certified Public Accountants. Accounting and Review Services Committee

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EXPOSURE DRAFT

**PROPOSED STATEMENT ON STANDARDS FOR
ACCOUNTING AND REVIEW SERVICES**

**COMPILATION OF SPECIFIED ELEMENTS, ACCOUNTS,
OR ITEMS OF A FINANCIAL STATEMENT AND PRO
FORMA FINANCIAL INFORMATION**

MARCH 18, 2005

**Prepared by the Accounting and Review Services Committee
American Institute of Certified Public Accountants**

**Comments should be sent by electronic mail to Michael Glynn at
mglynn@aicpa.org and received by June 10, 2005.**

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March 18, 2005

Accompanying this letter is an exposure draft of a proposed Statement on Standards for Accounting and Review Services (SSARS), *Compilation of Specified Elements, Accounts, or Items of a Financial Statement and Pro Forma Financial Information*. A summary of the significant provisions of the proposed SSARS follows this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the Accounting and Review Services Committee's (ARSC's) consideration of responses, comments should refer to specific paragraphs by number and include supporting reasons for each suggestion or comment.

Written comments will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after July 8, 2005, for one year. Comments should be sent via electronic mail to Michael Glynn at mglynn@aicpa.org and received no later than June 10, 2005.

Sincerely,

Andrew M. Cohen
Chair
Accounting and Review Services Committee

Charles E. Landes
Vice President
Professional Standards

**Accounting and Review Services Committee
(2004-2005)**

Andrew M. Cohen, *Chair*
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Technical Manager
Audit and Attest Standards

SUMMARY

The attached is an exposure draft of a proposed Statement on Standards for Accounting and Review Services (SSARS) entitled *Compilation of Specified Elements, Accounts, or Items of a Financial Statement and Pro Forma Financial Information*.

WHY ISSUED AND WHAT IT DOES

Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable to compilations and reviews of financial statements. By definition, presentations of specified elements, accounts, or items of a financial statement, or pro forma financial information are not financial statements. This proposed Statement will allow an accountant to compile and report on specified elements, accounts, or items of a financial statement and to compile and report on pro forma financial information in accordance with SSARS.

It should be noted that this proposed standard would apply when an accountant is engaged to compile, or does issue a compilation report on, specified elements, accounts, or items of a financial statement or pro forma financial information. The ARSC recognizes that this approach is inconsistent with Statements on Standards for Accounting and Review Services (SSARS) No. 1 through No. 11. Those Statements set forth performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or to third parties (SSARS No. 8, *Amendment to Statements on Standards for Accounting and Review Services No. 1*, Compilation and Review of Financial Statements [AICPA, *Professional Standards*, vol. 2, AR sec. 100], allows the accountant to either report on management use only financial statements, or document an understanding with the entity through the use of an engagement letter regarding the services to be performed and the limitations on the use of the financial statements). The ARSC believes that this approach to specified elements, accounts, or items of a financial statement or pro forma financial information (subject matter that is less than a financial statement as defined by SSARS No. 1 [AR sec. 100.04]) responds best to user and member needs while at the same time protecting the interests of the public.

This proposed Statement will not amend or revise the guidance in Chapter 4, “Reporting on Pro Forma Financial Information,” of Statement on Standards for Attestation Engagements (SSAE) No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 401), which provides guidance to a practitioner who is engaged to issue or does issue an examination or review report on pro forma financial information.

Additionally, this proposed Statement will not amend or revise the guidance in Statement on Auditing Standards No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623), as amended, which provides guidance when an independent auditor is requested to express an opinion on one or more specified elements, accounts, or items of a financial statement.

SPECIFIC REQUEST FOR COMMENT

In commenting on this proposed Statement, ARSC asks commentators to specifically comment on:

- Whether they agree with the approach that the standard would only apply when an accountant is engaged to compile, or does issue a compilation report on, specified elements, accounts, or items of a financial statement or pro forma financial information

Or

- Whether the proposed Statement should require a compilation report (or other means of communication) when the information is submitted due to the risk that a third party may infer an unintended level of assurance through the accountant's association with the specified element, account, or item of a financial statement or pro forma financial information.

EFFECTIVE DATE

The proposed Statement, if issued, would be effective for compilation reports of elements, accounts, or items of a financial statement and pro forma financial information issued on or after December 15, 2005. Early application is permitted.

HOW IT AFFECTS EXISTING STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

Although this proposed Statement will not affect any existing standards, it will expand the scope of information that an accountant may compile by allowing an accountant to compile specified elements, accounts, or items of a financial statement and pro forma financial information. Currently SSARS only provide guidance regarding compilation and reviews of financial statements as defined in SSARS No. 1 (AR sec. 100.04). The Accounting and Review Services Committee (ARSC) believes that by expanding the nature of information that may be compiled to include specified elements, accounts, or items of a financial statement and pro forma financial information, it will help members be more responsive to the needs of their clients and users of such information.

If this proposed Statement is issued, the ARSC will withdraw Interpretation No. 8, "Reports on Specified Elements, Accounts, or Items of a Financial Statement," of SSARS No. 1 *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.27-.28), because that interpretation currently states that SSARS would not apply to these items.

**PROPOSED STATEMENT ON STANDARDS FOR
ACCOUNTING AND REVIEW SERVICES**

**COMPILATION OF SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A
FINANCIAL STATEMENT AND PRO FORMA FINANCIAL INFORMATION**

1. Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable when an accountant submits unaudited financial statements to his or her client or third party. By definition, presentations of specified elements, accounts, or items of a financial statement, or pro forma financial information are not financial statements. This Statement expands SSARS to apply when an accountant is engaged to compile or does issue a compilation report on specified elements, accounts, or items of a financial statement or pro forma financial information.
2. A compilation of specified elements, accounts, or items of a financial statement and pro forma financial information is limited to presenting financial information that is the representation of management (owners) without undertaking to express any assurance on that information. (The accountant might consider it necessary to perform other accounting services to compile the financial information.)

**Specified Elements, Accounts, or Items of a Financial
Statement**

3. Examples of specified elements, accounts, or items of a financial statement that an accountant may compile include schedules of rentals, royalties, profit participation, or provision for income taxes.
4. If an accountant prepares or assists a client in preparing a schedule of specified elements, accounts, or items of a financial statement,¹ the accountant should consider how such a presentation of specified elements, accounts, or items will be used. When the information is likely to be used by a third party, the accountant should consider the potential of being associated with the schedule and the likelihood that a third party may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.
5. An engagement to compile specified elements, accounts, or items of a financial statement may be undertaken as a separate engagement or in conjunction with a compilation of financial statements.

¹ Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.45), provides guidance when the basic financial statements are accompanied by information presented for supplementary analysis purposes.

Understanding With the Entity

6. When engaged to compile one or more specified elements, accounts, or items of a financial statement, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding regarding the nature of the services to be performed should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide (a) that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and (b) that the accountant will inform the appropriate level of management² of any material errors, of any instances where the accountant has found indications that fraud³ may exist, or any instances where the accountant found indications that an illegal act⁴ may have occurred. The accountant need not communicate suspected illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated, but the accountant must report all instances where he or she has found indications that fraud may exist that come to his or her attention.
7. When the accountant is engaged to compile specified elements, accounts, or items of a financial statement and finds indications that fraud may exist or finds indications that an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.07-.08), as amended (new communication requirements in proposed SSARS *Omnibus Statement on Standards for Accounting and Review Services – 2005*).

Performance Requirements

8. When the accountant is engaged to compile or does issue a compilation report on specified elements, accounts, or items of a financial statement, he or she must adhere to the compilation performance requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.10-.12). (Numbering is pursuant to new paragraphs added to AR section 100 in proposed SSARS *Omnibus Statement on Standards for Accounting and Review Services – 2005*, referenced paragraphs are AR sec. 100.07-.09 in current Codification of Statements on Standards for Accounting and Review Services.)
9. Before issuance of a compilation report on specified elements, accounts, or items of a financial statement, the accountant should read such compiled specified

² When a fraud or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors.

³ For purposes of this Statement, fraud is an intentional act that results in a misstatement in compiled elements, accounts, or items of a financial statement and pro forma financial information.

⁴ For purposes of this Statement, illegal acts are violations of laws or government regulations, excluding fraud.

elements, accounts, or items of a financial statement and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the specified elements, accounts, or items of a financial statement, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

Reporting Requirements

10. When the accountant is engaged to compile or issues a compilation report on specified elements, accounts, or items of a financial statement, the basic elements of the report are as follows:
 - a. A statement that the specified element(s), account(s), or item(s) identified in the report were compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the specified element(s), account(s) or item(s).
 - b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
 - c. Describe the basis on which the specified element(s), account(s), or item(s) are presented if that basis is not generally accepted accounting principles and that that basis of presentation is a comprehensive basis of accounting other than generally accepted accounting principles.
 - d. A statement that a compilation is limited to presenting financial information that is the representation of management (owners).
 - e. A statement that the specified element(s), account(s), or item(s) have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it (them).
 - f. A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)
 - g. The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

11. Following are illustrations of accountant's compilation reports on specified elements, accounts, or items of a financial statement.

Report Related to Accounts Receivable

I (we) have compiled the accompanying schedule of accounts receivable of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying schedule of accounts receivable and, accordingly, do not express an opinion or any other form of assurance on it.

Report Related to the Schedule of Depreciation - Income Tax Basis

I (we) have compiled the accompanying schedule of depreciation-income tax basis of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The schedule of depreciation-income tax basis has been prepared on the accounting basis used by the Company for federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying schedule of depreciation – income tax basis and, accordingly, do not express an opinion or any other form of assurance on it.

12. An accountant is not precluded from issuing a compilation report on specified elements, accounts, or items of a financial statement for an entity with respect to which the accountant is not independent.⁵ If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

Pro Forma Financial Information

13. The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:
 - Business combination
 - Change in capitalization
 - Disposition of a significant portion of the business
 - Change in the form of business organization or status as an autonomous entity

⁵ In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct*.

- Proposed sale of securities and the application of the proceeds
14. This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).
 15. Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

Conditions for Compiling Pro Forma Financial Information

16. If an accountant prepares or assists a client in preparing pro forma financial information,⁶ the accountant should consider how such a presentation of pro forma financial information will be used. When the pro forma information is likely to be used by a third party, the accountant should consider the potential of being associated with pro forma financial information and the likelihood that a third party may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.
17. An engagement to compile pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation of financial statements. The accountant may agree to compile pro forma financial information if the document that contains the pro forma financial information includes (or incorporates by reference) complete historical financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) and, if pro forma financial information is presented for an interim period, the document also includes (or incorporates by reference) historical interim financial information for that period (which may be presented in condensed form). In the case of a business combination, the

⁶ Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.45), provides guidance when the basic financial statements are accompanied by information presented for supplementary analysis purposes.

document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity.

18. Additionally, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

Understanding With the Entity

19. When engaged to compile pro forma financial information, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding regarding the nature of the services to be performed should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide (a) that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and (b) that the accountant will inform the appropriate level of management⁷ of any material errors, of any instances where the accountant has found indications that fraud may exist, or instances where the accountant found indications that an illegal act may have occurred. The accountant need not communicate suspected illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated, but the accountant must report all instances where he or she has found indications that fraud may exist that come to his or her attention.
20. When the accountant is engaged to compile pro forma financial information and finds indications that fraud may exist or finds indications that an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1 (AR 100.07–.08) (new communication requirements in proposed SSARS *Omnibus Statement on Standards for Accounting and Review Services – 2005*).

Performance Requirements

21. When the accountant is engaged to compile or does issue a compilation report on pro forma financial information, he or she must adhere to the compilation performance requirements contained in SSARS No. 1 (AR sec. 100.10–.12). (Numbering is pursuant to new paragraphs added to AR sec. 100 in proposed SSARS *Omnibus Statement on Standards for Accounting and Review Services –*

⁷ When a fraud or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors.

2005, referenced paragraphs are AR sec. 100.07–.09 in current Codification of Statements on Standards for Accounting and Review Services.)

22. Before issuance of a compilation report on pro forma financial information, the accountant should read such compiled pro forma financial information, including the summary of significant assumptions,⁸ and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the pro forma financial information, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

Reporting Requirements

23. When the accountant is engaged to compile or issues a compilation report on pro forma financial information, the basic elements of the report are as follows:
 - a. An identification of the pro forma financial information.
 - b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
 - c. A reference to the financial statements from which the historical financial information is derived and a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)
 - d. A statement that the pro forma financial information was compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.
 - e. Describe the basis on which the pro forma financial information is presented if that basis is not generally accepted accounting principles and that that basis of presentation is a comprehensive

⁸ The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented. Nothing in this Statement should be interpreted to preclude the accountant from reporting on compiled pro forma financial information when management elects to omit substantially all disclosures. In that situation, the accountant should follow the guidance in SSARS No. 1 (AR sec. 100.16–.18).

basis of accounting other than generally accepted accounting principles.

- f.* A statement that a compilation is limited to presenting pro forma financial information that is the representation of management (owners).
- g.* A statement that the pro forma financial information has not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it.
- h.* A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)
- i.* The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

24. The following is an illustration of an accountant's compilation report on pro forma financial information.

I (we) have compiled the accompanying pro forma financial information as of and for the year ended December 31, 20XX, reflecting the business combination of the Company and ABC Company in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).⁹

A compilation is limited to presenting pro forma financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or any other form of assurance on it.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. However, the pro forma financial information is not necessarily indicative of the results of operations or related effects on financial position

⁹ Where one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within this report.

that would have been attained had the above-mentioned transaction (or event) actually occurred earlier.

[If the presentation does not include all applicable disclosures, the following paragraph should be added.]

Management has elected to omit all of the disclosures ordinarily included in pro forma financial information. The omitted disclosures might have added significant information regarding the company's pro forma financial position and results of operations. Accordingly, this pro forma financial information is not designed for those who are not informed about such matters.

25. An accountant is not precluded from issuing a compilation report on pro forma financial information for an entity with respect to which the accountant is not independent.¹⁰ If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

26. This Statement, if issued, is effective for engagements entered into after December 15, 2005. Early application is permitted.

¹⁰ In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct.